Corporate occupiers – maximising value from property

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Property is typically the second largest cost to any corporate. It therefore pays to be proactively thinking about property at all times to maximise efficiency and minimise cost.

It also pays to ensure that property strategy is aligned to, and supportive of, business strategy. While the benefits of this are by nature intangible, property flexibility is an important enabler to business success.

In this article we will consider some of the actions that businesses in all industries could and should be considering regarding their operational property portfolio in order to minimise costs and optimise their property position for the future.

It is worth emphasising that these actions are not just right for the depths of a credit crunch; they are the staples of any good practice in portfolio management. That said, with the 'cash is king' mentality necessitated by the current environment, it is accepted that the urge to act is likely to be greater at the moment. However, it is also true that these suggestions are not only appropriate for those businesses that may be in distress; they are also beneficial to organisations who currently find themselves in good health but still wish to enhance their business operations to consolidate and streamline their position.

Considering the current property position

Unfortunately, all too often property is ignored as it is not considered 'exciting' enough to warrant attention. As a result, occupiers carry on their day-to-day business without thinking about key questions such as:

- are we occupying our property as efficiently as possible?
- do we have spare space that we are not using?
- do we have any opportunities to exit surplus leaseholds or dispose of freeholds? and,

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- overall, could we structure our property portfolio in a different way that would enable us to reduce costs and preserve cash?

These questions should be considered at all times of the economic cycle, but in the current phase of the economic cycle the focus will no doubt be greater, due to the desire of all businesses to minimise costs. Consideration of these questions could identify opportunities for some immediate cash savings.

The answer to these questions may also influence the longer term property strategy. It is important that property strategy is aligned to support and enable the overall business strategy. Questions arise such as:

- How much is the business anticipating growth over the coming years and how will the business ensure there is sufficient property space to support this growth?
- How should acquisitions and disposals be managed in terms of the associated impact on property needs?
- When will key leases come to an end and will the business be able to renew?
- What is the environmental position of the group and are the properties it occupies consistent with this position?

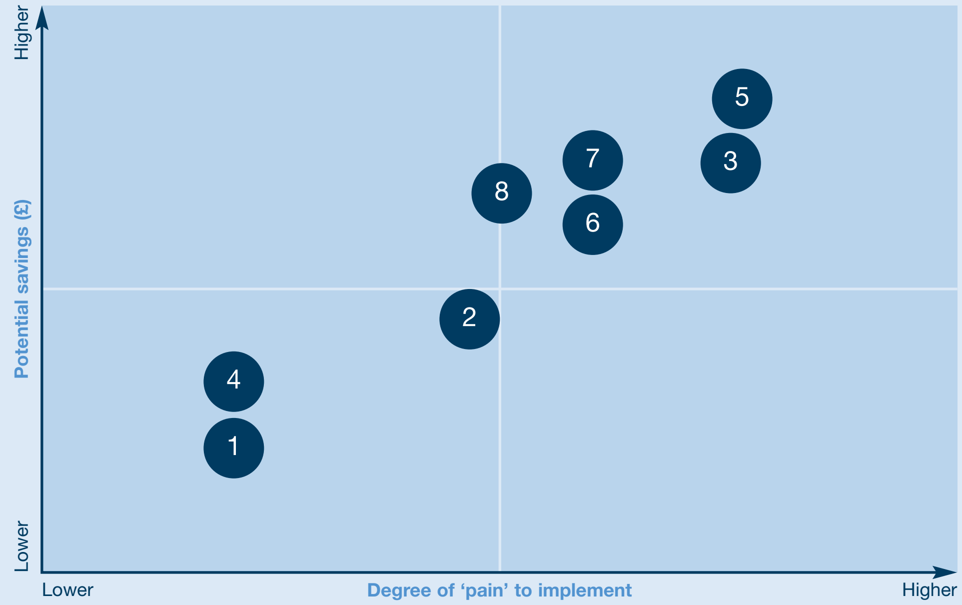
While a number of the suggestions that follow are potential 'quick wins' that can be undertaken in relative isolation of the overall property strategy, there are others that require a longer term understanding of the business direction and associated property requirements prior to being undertaken.

Opportunities and the challenge of implementation

Implementing change of any type in an organisation is not without its difficulties, and the extent of the difficulty presented will vary depending upon how radical a change is desired. The 'pain' comes from the fact that the status quo is being challenged and, as a rule, people do not like change. The options presented here, although largely being changes to property assets, do impact significantly on people as they are the users of those assets; however, the amount of upheaval required varies and, perhaps unsurprisingly, the pain correlates with the size of the benefit.

Figure 1 illustrates the relationship between the reward possible and the degree of pain required. Each number relates to a specific opportunity, and these are discussed in more detail afterwards.

Figure 1



Source: PricewaterhouseCoopers

Opportunity details

1) Review of facilities management service levels and costs

It is entirely possible and not uncommon that organisations are receiving a level of service from their facilities management (FM) provision that is more sophisticated than is really required. By reviewing items such as frequency of cleaning in offices, or levels of security guarding it is possible to realise immediate monetary savings.

It is also often advantageous to review existing contract pricing, and benchmark it against other providers to see if the business is obtaining a competitive price from its supplier.

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2) Consolidation of property contracts

In addition, it is not unusual to find in some multi-site organisations that they have procured property services in a very fragmented way. This can be quite common where the organisation is made up of a number of operating companies that tend to act independently of each other, but can still be the case in a single company that works across multiple sites.

The problem that arises is that the company fails to realise the benefits of its overall buying power when it is buying property services such as facilities management (cleaning, security, catering). By actively addressing this and combining the parts of the business for these purposes to optimise buying power, it is often possible to deliver significant savings to the organisation. If this is combined with the activities in 1) above, then the potential upside is even greater.

3) Consolidate staff into fewer buildings and dispose of vacated space

If times are proving particularly difficult for a company, they may have had to make a number of redundancies. Businesses may also have inherited and maintained employees in different locations, for example, through prior acquisitions.

In these instances it may be possible to consolidate staff into fewer buildings (for example, those that may be less marketable), or fewer floors within one building and realise savings from disposal of the vacated areas. Even where it is not possible to dispose of the space, either through a surrender or sublease with leasehold premises, or possible sales of freeholds, it could still be possible to realise some smaller savings by 'mothballing' – in other words, move the people out, turn off the lights and stop servicing the vacated space.

4) Business rates

If part of a property is 'mothballed', or is otherwise empty or underused, it may be possible to enter into negotiations with the local authority to agree discretionary relief from business rates.

Such negotiations are case and fact specific, but savings can be substantial. It is relatively easy to determine whether there could be worthwhile cash savings available, so is potentially an attractive 'quick win' in the current environment.

5) Adoption of more flexible working practices

For many organisations, the adoption of hot-desking and hotelling (pre-booking your desk) is new territory. In our experience, even those industries that are generally office-based will only have an average occupancy of about 50% (and many far lower than this) where they allocate fixed desk positions to staff. The reason for this is that, even where staff are designated as 'office-based', when factors such as sickness, holiday, training and attendance at meetings are included the office is never fully occupied. Therefore, by bringing in flexible working practices it is possible to increase the occupancy levels for the desks and use less space.

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6) Review internal property service function

While often a politically sensitive issue internally for a business to deal with, it is valuable to intermittently review the shape of an internal property department, and consider what elements could be outsourced and what capability should really be retained in-house.

In particular, if redundancies are being experienced across an organisation it is often some of the support functions that experience the first hits. This presents a first-class opportunity to review the overall property function and, in particular, its shape, size and operating model.

7) Structuring for tax efficiency and flexibility

When considering how to optimise value from property, it is important not to overlook tax factors. This is particularly so when considering longer term strategy – for example:

- Will a property need to be sold in a few years time due to growth in the business?
- If so, what type of purchaser is likely to be interested and what will they want to buy?
- What will the tax consequences be for the selling company?

and so on.

The current environment provides the perfect opportunity for property holdings to be restructured for flexibility. This is because property prices are depressed, so any taxable gain arising on the restructure should be lower than in recent years (and if the property was acquired recently, may even generate a loss). Businesses of course do not want to accelerate cash tax, but any gain can generally be deferred if a tax shelter does not otherwise exist.

As an example of restructuring that is topical at the moment, many corporate groups are currently transferring their UK properties to group non-resident landlord companies. Non-resident landlords are efficient for tax purposes, because any future gain on the property arises outside the charge to UK tax, and the company can be sold in due course with (depending upon territory) no stamp duty cost. It is usually also possible to benefit from an 8% tax rate arbitrage on net rentals if the property continues to be used by the group in the UK, because a non-resident landlord is subject to income tax at 20%, compared to a standard corporation tax rate of 28% for a UK company. The key issue with these structures is that the property needs to be managed outside of the UK.

Non-resident landlord structures are nothing new, but are appealing to purchasers due to their tax efficiency, so may make a property easier to sell in due course (the option of course remains to sell the underlying asset if parties prefer for any reason). Tax transparent structures such as partnerships or unit trusts can also be used in a similar way, which may be yet more attractive to purchasers in future (particularly funds).

If it is not practical to hold property via a group non resident landlord, it may be worth considering whether to move properties into group property companies in the UK instead. While some of the historic benefits of such 'Opco/Propco' structures are gone in the current climate, this may still make it easier to sell the property in future, due to the ability to sell a geared company paying 0.5% stamp duty on its value, rather than 4% stamp duty land tax on the full value of the property.

8) Funding pension deficits

Those who read the last edition of UK Real Estate Insights will have seen an article on using property to fund pension deficits. The content of that article will not be reproduced here, but it is worth highlighting in this context that property can be used to reduce pension fund deficits and thus save cash. It is not necessary for the property to be fully contributed to the pension fund for this to happen, so may be commercially attractive to many (and particularly those that are in industries where substantial working capital is tied up in property holdings).

Conclusion

To conclude, in the current environment, cash is of course king. A businesses' property portfolio presents a number of opportunities for saving costs and thus enhancing short-term cash flow. This is the case not only for distressed businesses, but also for those who are bearing up well to the current economic crisis and simply wish to consolidate and improve their position.

In this article we have noted the fact that change, while delivering clear financial benefits, also demands some pain on the part of the business. The amount of pain varies considerably, but then so does the reward, and therefore what we start to see is a clear spread of actions that could be considered 'quick wins' while others are longer term opportunities. Deciding what is right for each client requires some discussion, but the fact remains that there are things that can and should be considered now by clients, particularly if they are finding the current economic climate difficult, while also having opportunities to undertake actions to position themselves better in the longer term.

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